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The Rise of Mid-to-High End Chinese Restaurant Chains in Shanghai

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Report Highlights:

Shanghai is home to the largest restaurant industry in China. In 2009, sales were up 13 percent to 70 billion Rmb (\$10.3 billion). There are currently 38,000 restaurants in Shanghai falling into four main categories – Chinese, Western, Fast Food, and Casual Dining. Within the past five years, restaurant chains have become a dominant player in every category. This trend is shaping the industry as consumers demand higher quality food and become more brand loyal. Upscale Chinese restaurant chains, with an average check \$25 per person, constitute a growing niche within this sector. These restaurants cater to the emerging middle class of Chinese consumers and represent a potential entry-point for U.S. products into the Shanghai market, including beef, seafood, nuts, processed fruits, and wine.

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Shanghai is home to the largest restaurant industry in China. In 2009, sales were up 13 percent to 70 billion Rmb (\$10.3 billion). There are currently 38,000 restaurants in Shanghai falling into four main categories – Chinese, Western, Fast Food, and Casual Dining. Within the past five years, restaurant chains have become a dominant player in every category. This trend is shaping the industry as consumers demand higher quality food and become more brand loyal. Upscale Chinese restaurant chains, with an average check of \$25 per person, constitute a growing niche within this sector. These restaurants cater to the emerging middle class of Chinese consumers and represent a potential entry-point for U.S. products into the Shanghai market.

Up and coming restaurants in this sector include Xiao Nan Guo, South Beauty, Jade Garden, Golden Jaguar, and Shao Xing. As these mid-to-high end restaurant chains mature, common trends are developing. The companies are putting together talented management teams to oversee ambitious growth plans and are looking to finance expansion through private equity investments or IPO's. They are consolidating in-bound and out-bound food deliveries at a "central kitchen" location to build economies of scale. The companies are focusing on improving brand awareness and are diversifying into other lines of business such as fine-dining, outside catering, and fast food. Finally, these restaurants are increasingly adding fusion dishes to their menus and making food safety a top priority.

U.S. products such as beef, chicken, seafood, wine, frozen vegetables, dairy products, processed fruits, and nuts have the best prospects for penetrating this sector. In fact, a proven method for getting products into distribution channels in Shanghai is to begin in the hotel and restaurant industry. To do so U.S. food and beverage exporters must identify the major players and target key decision makers within these organizations including their suppliers and distributors. A recommended marketing strategy is to hold promotional events that educate industry representatives, such as head chefs and purchasing managers, about the strengths and proper uses of U.S. products. Similar to the wine industry, first movers will gain a big advantage in this market. Going forward U.S. exporters could see additional sales opportunities as these companies expand, diversify into other businesses, and develop the capability to import directly.

Introduction

Chinese restaurant chains catering to the emerging middle and upper classes have recently surfaced in Shanghai. We studied several "mid-to-high" end restaurants [1] and found a number of common trends and opportunities for U.S. food exporters.

The report is divided into three sections. The first section offers a general overview of the market conditions in China and Shanghai, focusing on income growth, spending patterns of the emerging middle class, and the food culture in Shanghai. The second section highlights trends in the Shanghai restaurant industry, specifically those related to mid-to-high end restaurant chains, and profiles its major players. The third section identifies best prospects for U.S. products in this sector and strategies for entering the market.

While the report provides the reader with background information, an in-depth analysis of chain restaurants, and recommendations for U.S. exporters, each section can be read independently. For instance, those readers with a familiarity of the current economic conditions in China and Shanghai may choose to skim the first section and focus more on the analysis of the restaurant industry.

Section I. China & Shanghai Market Conditions

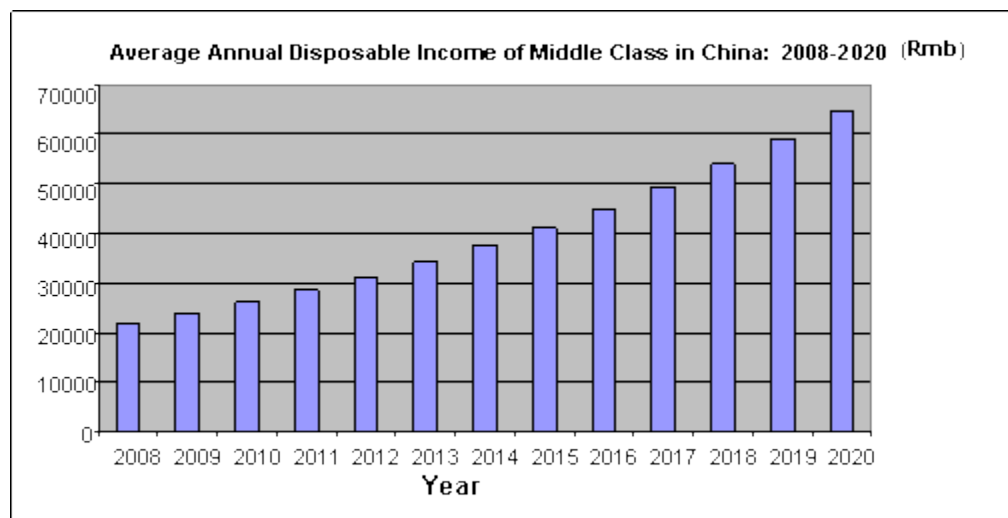
A. Economic Overview

GDP Growth

Despite the global recession, China experienced strong economic growth throughout 2009. GDP grew 8.9 percent year-over-year to \$8.7 trillion, making it the third largest economy in the world, just shy of Japan. This came after robust GDP growth in 2007 and 2008 of 13 percent and 9 percent respectively. Perhaps even more telling of the country's remarkable economic growth story, though, is the average annual growth rate (AAGR) in GDP of 10.5 percent achieved over the last decade (IMF).

Rising Disposable Income

Per capita GDP, a proxy for residents' standard of living, has followed suit, up 9.6 percent in 2009 to \$6,500. Although much lower than the comparable U.S. figure of \$46,600, per capita GDP has nearly *tripled* in China since 2000 (IMF). If the country can maintain these remarkable growth rates we will see urban spending patterns reflecting a rising standard of living, a trend that will benefit U.S. agricultural exporters as consumers increasingly demand high-quality products. The chart below offers a glimpse into forecasts of income growth for Chinese middle class families. According to Euromonitor, middle income households in China are expected to see an AAGR in disposable income of 9.5 percent from 2008-2020 compared to a modest 2 percent growth rate in the U.S. during the same period. Notice disposable income is set to triple in China over the next twelve years growing from 21,000 Rmb to 63,000 Rmb by 2020.



Source: Euromonitor/ATO Shanghai

This has numerous implications for U.S. food companies looking to enter China or expand their market share here. First, given the sheer size of the market, it will become increasingly important to target a subset of Chinese consumers. In doing so, a company can tailor their marketing strategy to effectively reach the target demographic while utilizing fewer resources. Equally important, companies should analyze the spending patterns within this demographic group to better understand which sectors will profit the most from their increasing purchasing power. This report provides insight into one area that will surely benefit from these rising income levels - the restaurant industry.

B. The Emerging Middle and Upper Classes in China

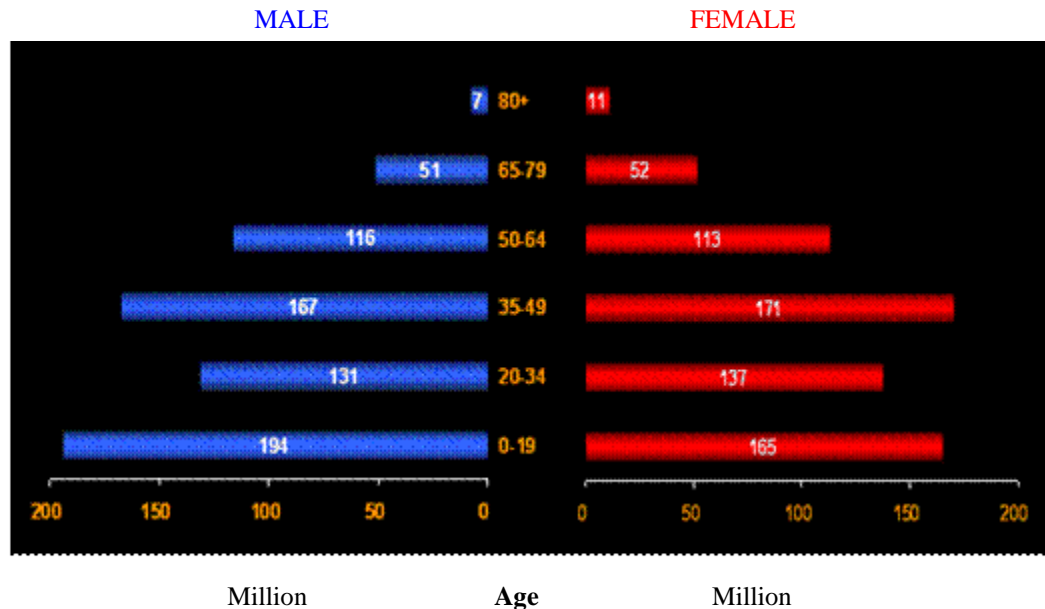
The Middle Class

The typical middle class family in China is a two income household with one child. Increasingly one or both of the parents will at least have a college degree. As a general rule, educated Chinese middle class families tend to be more open to expenditure on food and entertainment. Foreign goods, premium brands, and trendy places in particular are favored by the

more educated. Despite shortfalls in the social security and health care systems, this particular demographic does not deviate from the contemporary attitude of spending more and saving less. Going forward, improvements to these social institutions combined with a stronger currency will further stimulate domestic consumption among this emerging middle class of consumers.

According to the Euromonitor, the middle class in China is expected to reach 700 million people by 2020 (compared to less than 100 million in 2007) [2]. Below is a demographic breakdown of the Chinese population. Interestingly enough, there are more people living in the country under the age of 20 than in the entire U.S.

Chinese Population: Breakdown by Age & Sex



Source: China Statistical Yearbook 2008/ATO Shanghai

Notice the often reported gender imbalance is most prevalent in the 0-19 age category. This imbalance will no doubt have a multitude of unpleasant consequences in the future, ranging from a rise in human trafficking and prostitution to higher rates of drug use. However, there are certain industries that stand to benefit from this unintended outcome of the one-child policy. For example, the real estate and restaurant industries are likely to thrive in such an environment. In the later, we can expect overall food expenditures at upscale restaurants to steadily increase as a growing number of affluent Chinese men attempt to court and find a partner from a shrinking pool of females.

Delaying Marriage

In cities such as Shanghai, we are beginning to see a trend where younger people are waiting longer to get married. In 2009, the average age of marriage for a Shanghainese man was 32 years old and 29 for women, a full year later than the respective 2008 data (SSY 2009). This can be attributed to a greater focus on career, the rising cost of housing, and a greater sense of independence. As individuals delay major life events like marriage, purchasing an apartment, and raising children, we will see spending patterns typical of the younger demographic being extended into people's thirties. This will benefit the restaurant industry in Shanghai as consumption of food-service, expenditure on alcohol, and a generally more self-centered lifestyle will become the norm for a larger segment of the population.

The Upper Class

Meanwhile, the number of rich Chinese continues to grow exponentially. The majority of China's wealthy [3] are young, on average, 20 years younger than those in the United States and Japan. In fact, 80 percent of China's wealthy consumers are

below 45 years of age, compared to 30 percent in the United States and 19 percent in Japan, according to a McKinsey report. For this demographic, status and “face” are extremely important. They have fully embraced a materialistic lifestyle. Indeed, China will soon replace Japan as the world’s largest luxury consumer market.

C. Food Expenditure in China

Food expenditures make up a large portion of the Chinese family’s growing income. In 2008, for instance, food expenditures for the average Chinese household were 36 percent of disposable income. Similar to the experience of the U.S., as the food industry in China slowly consolidates and productivity improves, we can expect food expenditures as a percentage of income to decrease over time. However, during this transition there will be a corresponding shift among Chinese consumers to higher quality goods and more expensive brands. They will also demand more variety and convenience as their living standards improve. Consequently, we will see a growing number of Chinese households incorporate more high-value products from the U.S. such as beef, seafood, wine, nuts, cheese, and processed fruits into their diet.

A proven method for getting new-to-market products into distribution channels in China is to begin in the hotel and restaurant industry. In general, Chinese customers are more adventurous when dining out, eager to try something new while trusting the chef to select foreign foods they will like. U.S. food and beverage exporters must act quickly to pursue this opportunity. They should begin by developing a strategy that best positions their products to compete in this sector. Initially they must:

- Understand trends that are shaping the industry
- Identify major players within the industry
- Target and develop relationships with key decision makers within these organizations including suppliers and distributors
- Educate industry representatives about the strengths and proper uses of U.S. food ingredients
- Conduct market research to better understand customer’s demands and taste preferences

In this report, we will provide insight on a number of these topics for an emerging sector in the Shanghai restaurant industry - mid-to-high end Chinese restaurant chains.

D. Food Culture in Shanghai

Why Shanghai?

The majority of the restaurant chains highlighted in this report were launched in Shanghai. Others were started elsewhere, yet they chose Shanghai as their first city for expansion. The same can be said for many Western chains that have recently entered the Chinese market. So why is Shanghai on every food company’s radar?

A Special Place

Shanghai is the commercial center of China and has been a major contributor to the country’s rapid economic expansion since opening up to foreign investment in 1979. In fact, in 2009 Shanghai’s total GDP surpassed that of Hong Kong for the first time, growing 8.2 percent year-over-year to \$218.3 billion. Per capita GDP in Shanghai was among the highest in the country in 2008 at 73,124 Rmb (\$10,750), a 10.2 percent increase over the previous year (Shanghai Statistical Yearbook 2009).

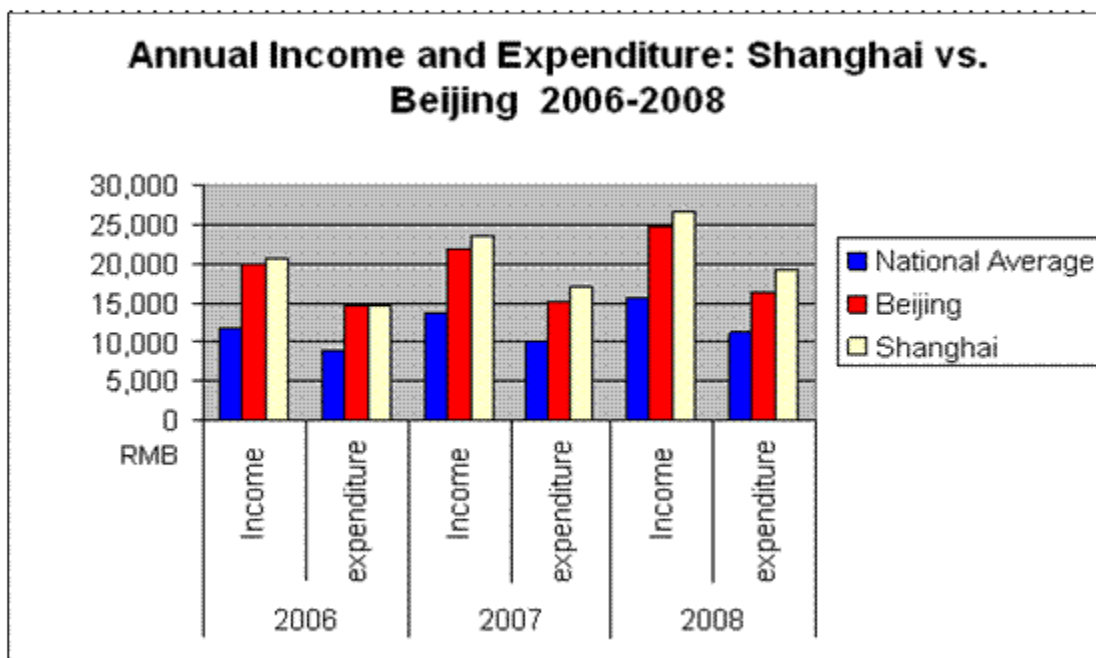
More importantly, Shanghai possesses a number of unique characteristics which, taken together, offer restaurants a compelling argument for establishing operations in its marketplace. They are listed as follows:

- Local residents have the spending power to support a growing number of restaurants.

- People in Shanghai dine out more frequently than their fellow countrymen.
- The Shanghainese are open-minded and welcome outside influences as evident by the wide selection of cuisines available in the city.
- Trends catch on quickly among the local population and residents of 2nd and 3rd tier cities often take their cues from Shanghai, paving the way for expansion into these markets.
- The local labor force includes a relatively high number of college graduates, especially business majors. This combined with the large number of existing international businesses in Shanghai creates a wealth of talented young professionals to choose from when building a management team.

Shanghai vs. Beijing

By comparing the differences in wealth and spending patterns between Shanghai and Beijing residents, one can get a better handle on some of the numbers driving a restaurant's decision to debut in the Shanghai market. The chart below displays disposable income and expenditures for Shanghai, Beijing, and the nation as a whole from 2006 to 2008.



Source: China Statistical Yearbook 2009/ATO Shanghai

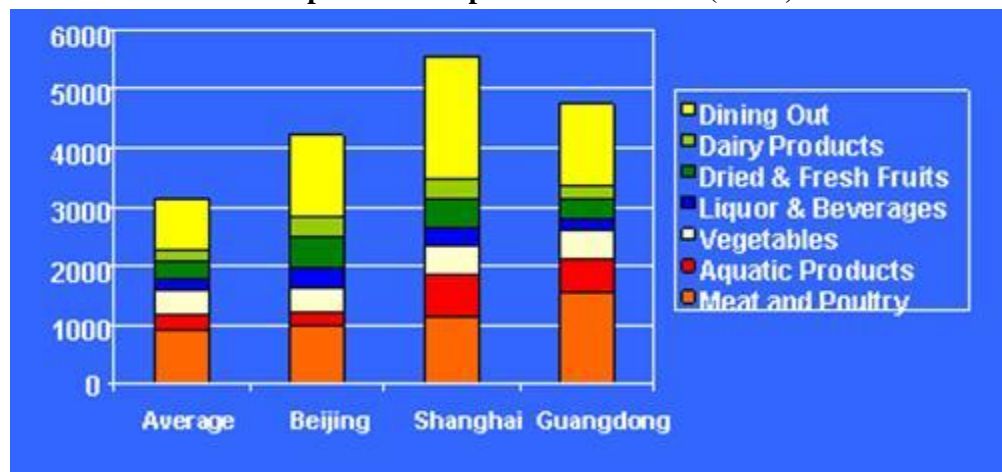
During this time period, residents of Shanghai and Beijing saw their disposable incomes rise at roughly the same rate, increasing 29 percent and 24 percent respectively. The major difference between the two cities can be found in the savings rate. Over the same time period, expenditures increased by 31 percent in Shanghai compared to a modest 11 percent gain in Beijing. In fact, Shanghai residents spent almost 3,000 RMB more than Beijing residents in 2008, a change from 2006 when expenditures were almost identical. Approximately 35 percent of that expenditure went towards food and dining out.

Food Expenditure in Shanghai

Average disposable income in Shanghai is over twice the national average, coming in at 28,838 Rmb (\$4,240) in 2009. Food expenditures meanwhile accounted for 27 of this income. The chart below provides a breakdown of its components and a comparison to the two other largest Chinese cities (Beijing and Guangzhou) as well as the national

average.

Annual Per Capita Food Expenditures in 2008 (RMB)



Source: Shanghai Statistical Yearbook 2009/ATO Shanghai

As you can see, Shanghai residents spend a great deal more on food than do residents of Beijing or Guangzhou. In particular, the Shanghainese consume significantly more aquatic products than the average Chinese person. In addition, they dine out much more frequently than their counterparts in the other tier-1 cities. In 2008, Shanghai residents spent on average 2,068 Rmb dining out or 7 percent of their disposable income, a 20 percent increase over the previous year. Dining out is an integral part of the Shanghainese way of life, so expect to see continued growth in this area in the future.

A Smorgasbord of Restaurants

Locals not only enjoy dining out, they also like to frequent a variety of different restaurants, from traditional Chinese to Western fast food to specialty desert shops. Over the years, the city has become a virtual melting pot of assorted cuisines. By simply walking through any of the central business districts downtown, you get a feel for just how vibrant the food culture is in the city. Indeed, Shanghai residents are unique for their willingness to embrace a variety of different cuisines from all over China. There are a growing number of restaurant chains offering dishes from regions such as Sichuan, Guangdong, Hebei, Zhejiang, and Hong Kong. A local saying speaks to this uniquely Shanghai tendency to welcome outside influences, “Hai nan bai quan” which roughly translates to “Many rivers come together to meet the sea”.

The Shanghainese: Trend Setters

The Shanghainese are entrepreneurial by nature, meaning they are more willing than their fellow compatriots to take risks and to try new things. Consequently, many trends in the food industry find their roots in Shanghai. In fact, residents of smaller, inland cities often imitate the behaviors of the Shanghainese, so trends that begin in Shanghai usually make their way into these cities within a few years. A recent trend that has taken off in Shanghai is the emergence of mid-to-high end Chinese restaurant chains, serving traditional Chinese cuisine and fusion dishes. If the past is any indicator, this trend will trickle down to other Chinese cities within the next few years. Next, we will examine this growing industry in more detail.

Section II. Analysis of Restaurant Chains in Shanghai

A. The Shanghai Restaurant Industry: An Overview of Mid-to-High End Restaurant Chains

The restaurant industry in Shanghai continues to see strong growth. According to the Shanghai Restaurant Association, total sales were up 13 percent in 2009 to 70 billion Rmb (\$10.3 billion). In fact, Shanghai takes the top spot among Chinese cities in terms of total restaurant sales. In the first quarter of 2010 sales increased 10 percent year-over-year. Industry experts

expect even stronger growth in the second and third quarters due to an influx of domestic and foreign tourists for the 2010 World Expo which runs from May 1st to October 31st.

There are currently a total of 38,000 restaurants in Shanghai. Broadly speaking, these restaurants fall into four main categories – Chinese, Western, Fast Food, and Casual Dining. Industry analysts are beginning to see a greater variety of restaurants within these four categories. As previously mentioned, Shanghai residents are uncharacteristically open to outside cuisines. For instance, Chinese restaurants specializing in food from regions such as Sichuan, Hubei, Zhejiang and Guangdong are regularly opening up new outlets in the city. This is one of the reasons the Shanghai restaurant industry continues to experience strong growth.

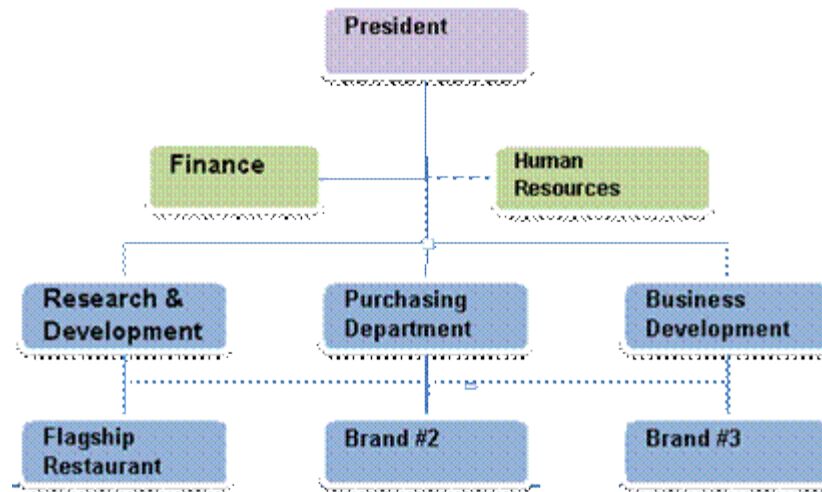
A.1 Industry Trends

The industry as a whole has responded well to customer's demands for more variety, consistent quality, and a broader selection of dishes. Meanwhile, a number of common trends are emerging among the major Chinese mid-to-high end restaurant chains in Shanghai as they mature and become more sophisticated. For example, restaurant groups are forming talented management teams to oversee ambitious growth plans and are looking to finance expansion through private equity investments or IPO's. They are consolidating in-bound and out-bound food deliveries at a "central kitchen" location to facilitate their growth. The companies are focusing on improving brand awareness and diversifying into other lines of business such as fine-dining, outside catering, dessert shops, hotels, and fast food. Finally, they are increasingly adding fusion dishes to their menus and making food safety a top priority.

Corporate Management and Organizational Structure

Chain restaurants understand how vital good management is to running a successful business, especially in times of expansion. The most successful chains have set up a functional organizational structure which typically includes purchasing, R&D, and finance departments and business development and human resource divisions. This structure evolved over time, as the restaurant grew organically. The chart below depicts the typical organizational structure for a chain restaurant company in Shanghai.

Organizational Structure of a Chain Restaurant Company in Shanghai



Source: ATO Shanghai Interviews

R&D and Purchasing Departments

In the face of fierce competition, chain restaurants in Shanghai are focusing a lot of their attention on constantly bringing new dishes to their menu. The R&D department, which consists of an executive chef and a group of experienced chefs, is fundamental to this process. After chefs create a new dish, they will collaborate closely with the purchasing department to source the ingredients.

New ingredients can also inspire new ideas. Hence, the purchasing manager may present a new ingredient to the chefs and ask them to create a new dish out of it. For this reason, it is critical for U.S. companies to offer training to chefs to educate them about ingredients currently available on the market and to promote new ingredients.

Central Kitchen

A central kitchen has become a must for chain restaurants. It serves as a “food hub”, a place to consolidate deliveries, processing, and out-bound shipments of food products. Most food ingredients, with the exception of produce, are delivered to the central kitchen for processing and preparation. Some restaurants even package ingredients into single-serving sizes such as pre-cut portions of marinated beef tenderloin. When finished, the ready-to-cook or semi-cooked food products are delivered to each restaurant location.

There are several benefits of operating a central kitchen. First, it is an effective way to maintain consistent food quality at each restaurant, in terms of flavor, ingredients, and quantity. Second, it saves cost for the chain restaurant. Because much of the food preparation is done at the central kitchen location, it requires less kitchen space and staff at each restaurant location. Third, it lays the ground work for rapid expansion to scale up as needed.

Diversification

Building on the success of their flagship restaurant chains, many companies have developed new brands or expanded the services they offer. A prevalent trend has been to open a high-end chain under a different name, where the average check is above 300 Rmb (\$44) per person. Purchasing managers indicated that more imported ingredients will be featured on the menus at these fine-dining restaurants in the future.

Some restaurant groups are going the opposite way by targeting the mass market. Against the face of continually rising

operational costs, mainly in the form of higher rent and wages, these companies are setting up smaller restaurants which offer fewer, more easily prepared food choices. These establishments usually fall under the casual dining or Chinese fast food category.

Diversification has also occurred within existing restaurant chains. For instance, some leading restaurants are offering outside catering services for special events. Another major source of revenue comes from hosting wedding receptions, company annual meetings, and conventions at an in-house ballroom. These venues often have built-in stages with audio and video equipment. Some restaurants even staff in-house experts to design and coordinate such events for their customers. These value-added services appeal to a wide customer base and capture market share in this lucrative niche from the prevailing market leader – four and five star hotels.

Focus on Food Safety

Food safety has become a top priority for Chinese consumers and producers alike. In the restaurant industry this has translated into a concerted effort to hold suppliers liable for delivering a safe and quality product. For this reason, purchasing departments prefer to deal with larger suppliers with a proven track record. Many restaurant chains boast exemplary food safety records as a result of their increased surveillance. In fact, this is a major reason for the recent popularity of restaurant chains among the local population. Consumers choose to dine at these upscale establishments for the peace of mind and are willing to pay a premium for a meal they know to be safe. Therefore, U.S. food exporters can emphasize the superior quality of U.S. products when approaching suppliers and purchasing managers of restaurant chains.

Market Constraints

Among the many challenges the restaurant industry will face over the next few years, nearly all managers cited increasing operational costs as their primary concern. The cost to lease commercial space in Shanghai is high and is increasing annually at a much faster rate than other Chinese cities. This comes against the backdrop of increasing wage pressure from restaurant employees and management. The anticipated shortage of labor in the food service industry will only make the situation worse. Because the restaurant industry is not regarded as a “golden industry” in China, chain restaurants are experiencing high-turnover rates and fewer young, blue-collar or semi-skilled workers are looking to get into the catering and food service industry. Therefore, it is likely that restaurants will need to pay higher salaries going forward to recruit qualified staff, including chefs, sous-chefs, wait staff, and other restaurant employees.

Future Growth and Expansion to Other Markets

The mid-to-high end chain restaurant industry should continue to see strong growth in the Shanghai market. The primary reasons are as follows:

- The Shanghainese have the spending power to support upscale restaurants
- Consumers have become more brand loyal, meaning chain restaurants will benefit as their reputation grows
- The local government is making investment in the restaurant industry more appealing by lowering barriers to entry and eliminating regulations.
- Business activity remains strong in Shanghai which will translate into a rising number of business-related restaurant visits.
- Chinese companies flush with capital from the surrounding provinces are investing in the restaurant industry in Shanghai, viewing chain restaurants in particular as a relatively safe and potentially lucrative industry

Currently, coastal cities like Shanghai, Beijing, Guangzhou, Hangzhou, Tianjin, Qingdao, and Wenzhou are taking the lead in the chain restaurant industry. However, emerging city markets (ECM's) farther inland like Chengdu, Chongqing and Kunming offer good opportunities for expansion as the potential in these markets is huge. Industry analysts also expect to see more international expansion from the major restaurant chains in the near future.

Going Public

Some leading restaurant companies are going public or using venture capital from private equity groups to finance their growth. Among the major mid-to-high end restaurant chains in Shanghai, Xiao Nan Guo, Jade Garden, and Golden Jaguar all plan to raise capital through an IPO on the Chinese stock market in the near future. While this will certainly provide the necessary capital to finance their rapid expansion, these companies will have to answer to shareholders demanding short term results.

B. General Attributes of Major Players in the Mid-to-High Restaurant Chain Sector

Restaurant Categories

The Chinese restaurant chains highlighted in this report generally fall into six subcategories:

1. Shanghainese
2. Eastern Chinese
3. Regional Chinese
4. Seafood
5. Buffet
6. Steakhouse

Each subcategory corresponds to the type of food being served at the restaurant. For example, Xiao Nan Guo primarily features Shanghai cuisine on their menu. South Beauty, on the other hand, serves dishes originating from Sichuan, a regional cuisine from the southwest of China.

Major Players

Below is a list of the major players operating in the mid-to-high end chain restaurant sector in Shanghai:

Major Players in the Shanghai Restaurant Industry

Restaurant	Category	# of Branches	Cities	Avg Meal Price/Person		Other Brands
				Rmb	USD	
Xiao Nan Guo (小南国)	Shanghainese	30	Shanghai (14), Hong Kong (8), Beijing (4), Suzhou (2), Nanjing (1), Dalian (1)	200	\$29.50	Hui Gong Guan (4), Da Wei Lai, XNG Spa
Jade Garden (苏浙汇)	Eastern Chinese	16	Shanghai (9), Beijing (2), Macao (1), Suzhou (1), Hangzhou (1), Shenzhen (1), Hong Kong (1)	200	\$29.50	Dou Xiang Yuan (1), Tian Cui Ting (1)

South Beauty (俏江南)	Regional Chinese	36	Beijing (18), Shanghai (13), Chengdu (1), Shenzhen (1), Tianjin (1), Suzhou (1), Qingdao (1)	150-200	\$22 - \$29.50	LAN Club (2), STEAM (1), SUBU (1)
Shao Xing (绍兴)	Regional Chinese	12	Shanghai (9)	150	\$22.00	Cui Ting Xuan (3)
Golden Jaguar (金钱豹)	Buffet	9	Shanghai (3), Beijing (3), Shenyang (1), Tianjin (1), Zhengzhou (1)	200	\$29.50	Club du Jardin, GJ Catering
The Dong Jiang Seafood Group (東江海鮮)	Seafood	24	Guangzhou (20), Shanghai (1), Fushan (1), Shenzhen (1), Nanjing (1)	150-200	\$22 - \$29.50	-
Bullfighter (斗品膳)	Steakhouse	45	Shanghai (8), Jiangsu (8), Fujian (11), Hangzhou (5), Ningbo (3), Zhejiang (3), Chongqing (3), Wuhan (2), Shanxi (1), Qingdao (1)	150-200	\$22 - \$29.50	-

Source: ATO Shanghai Interviews

Ownership

These restaurant chains are owned and operated by Chinese or Taiwanese companies. According to the general manager at Shao Xing, a considerable number of locally based mid-to-high-end restaurant chains were actually started by entrepreneurs from outside the city (Eastern China, Taiwan, and Hong Kong). Additionally, some of the groups opening restaurant chains in Shanghai have expertise or previous experience in the real estate industry, a big asset when selecting a strategic location to open a new branch. In most cases though, the founder's expertise lay solely in the restaurant industry. The owners of these restaurant chains had the foresight to bring in outside management to guide the financial and operational aspects of the business during expansion. This is a major reason for their success.

On the whole, these companies are growing organically, methodically opening up new branches in select markets. Bullfighter, on the other hand, has decided to franchise their restaurant, though anecdotal evidence suggests they are having trouble with quality control at many of their franchised locations.

Going Fusion

The menus at these restaurant chains primarily feature traditional Chinese dishes from a specific region, such as Zhejiang (Eastern) or Sichuan (Southwest). However, there is a general trend to offer more fusion dishes to their customers. Fusion means serving Chinese food in a Western manner or applying Western ingredients to Chinese food. When it comes to Western ingredients, chefs are developing new applications to ensure the dish caters to Chinese preferences and is affordable. Below is an assortment of fusion dishes currently offered on their menus:

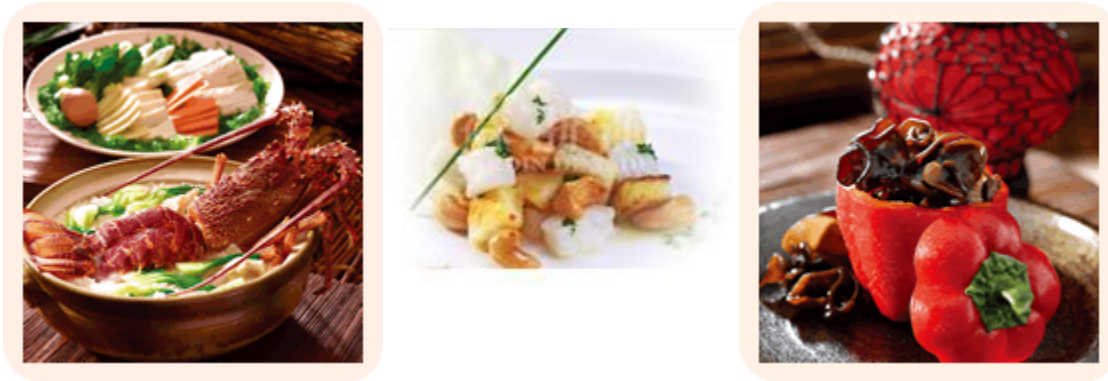
Selection of Fusion Dishes from Menus at Mid-to-High End Restaurant Chains in Shanghai

Dish	Price		Restaurant
	Rmb	USD	
Sautéed Australian Abalone with Green and Red Peppers (spicy sauce)	488 Rmb/jin	\$65.10/lb	South Beauty
Pan Fried Lobster with Red Chilies	580 Rmb/jin	\$77.40/lb	South Beauty
Grain Fed Beef Short Ribs cooked in a Chinese Style	128 Rmb	\$18.80	Bullfighter
Surf & Turf (6 oz. Tenderloin + Cheese Crab, Teriyaki Eel, Cheese Scallops or Meuniere Cod)	108 Rmb	\$15.90	Bullfighter
Cod with Cashews and Lemongrass	78 Rmb	\$11.50	Jade Garden
Chinese Mushrooms served in Red Bell Pepper	38 Rmb	\$5.60	Xiao Nan Guo
Rock Lobster cooked in clay pot with Mixed Veggies	618	\$82.45/lb	Xiao Nan

	Rmb/jin		Guo
Garden Salad with Blueberry Dressing	*	*	Golden Jaguar
Beef Tenderloin with Black Pepper Sauce	*	*	Golden Jaguar

*Items included in full buffet (price - 198 Rmb/person or \$29)

Source: ATO Shanghai Interviews



These are representative of the types of fusion dishes being served at Chinese restaurant chains in Shanghai. Fusion cuisine not only appeals to the adventurous Shanghainese palate but can also differentiate a restaurant in this competitive market. Notice the focus of the dish is often an imported seafood or specialty meat item with flavors and spices derived from a traditional Chinese dish. For example, South Beauty is a high-end restaurant chain specializing in Sichuan cuisine, famous for its hot and spicy flavors. Their menu includes two main courses featuring imported seafood items from Australia – rock lobster and abalone – each prepared with a classic Sichuan twist. As much as 30 percent of the menu items at these restaurant chains incorporate some Western element. In fact, several of the restaurants interviewed hold special promotions throughout the year highlighting imported menu offerings.

Key Decision Makers

These restaurants follow one of two models when selecting new ingredients to incorporate into their menu. First, the head chef or the R&D team can create a new dish, thereby dictating which ingredients need to be sourced. The purchasing team then identifies the best domestic or international supplier to provide the necessary ingredients. Second, suppliers can approach the purchasing team with a new, appealing product or ingredient. Subsequently, the R&D team will find a way to incorporate it into the menu. From this we see the major decision makers to target in these organizations are generally the head chef, the purchasing managers, and/or members of the R&D team.

Often, the decision makers will have conflicting goals steering their decision. The head chef, for instance, may be looking to create a dish that, while appetizing and unique, can be consistently reproduced by other chefs working in the restaurant. Cost, quality, and food safety will likely be major driving forces for purchasing managers. In addition, supplier availability and reliability will affect their decision. The R&D team, on the other hand, may be looking to create a dish that is innovative or has a high-perceived value among customers.

Presentation

Presentation is an important aspect of Chinese cuisine, with particular focus on color, flavor, and texture. Dishes at these mid-to-high end chain restaurants are typically served in the Chinese “family style”, where each dish is shared by all members of the table. There are certain seafood dishes (lobster and crab) and beef dishes (steak) that cannot be easily prepared in this manner. Interestingly enough, the R&D teams at several of these restaurants are exploring innovative ways

to incorporate traditionally single-serving products such as fish, beef, and lobster into a dish that can be shared. Chopsticks, the primary eating utensils at these restaurants, also limit the types of dishes that can be offered and restrict how the chef can present the dish. Therefore, it is important for chefs to be creative and to adapt their cooking methods accordingly when using foreign ingredients. This will allow them to create dishes that appeal to Chinese clientele without compromising the quality of the primary ingredient. Developing these skills requires chef training and demonstrations from foreign chefs on the best uses of Western ingredients.

Ambiance

In the past, Chinese restaurant owners paid little attention to atmosphere. The companies managing these mid-to-high end restaurant chains are focusing more of their time and resources on decorating the interior of their restaurants. The trend has been either to create a modern, chic ambiance with elements of traditional Chinese feng shui (an ancient Chinese approach to a pleasing environment) or to follow a classical Chinese theme. The design will often vary from location to location, but the overall theme is maintained. Ultimately, management wants to attract an increasingly sophisticated Chinese customer and to complement the presentation of their dishes.

Layout

In addition, layout is extremely important to attracting the restaurant's target customer base. Restaurant chains featured in this report devote as much as 30-50 percent of their available space to private dining rooms. In particular, this setting appeals to Chinese businessmen, families, and government officials, who may spend up to three hours at the restaurant celebrating a special occasion or the closing of a business deal. Meanwhile, restaurants typically see higher average returns from these private rooms versus traditional table dining.

Price and Target Customers

The average price per person at these mid-to-high end restaurant chains is 150-200 Rmb (\$22.05-\$29.50). Based on average spending patterns and number of restaurant visits per month by Shanghai residents, one restaurant extrapolated that the average customer's monthly salary will be 5,000-20,000 Rmb (\$735 - \$2,940). In general, this segment of consumers includes middle to upper-middle class businessmen, young professionals, government officials, and families.

Profit Margins

According to the Shanghai Restaurant Association, these restaurant chains are seeing average profit margins of 10-13 percent. However, increasing competition and rising operating costs are threatening to eat away at these already slim margins. Therefore, management teams are looking to tweak their menus to maximize perceived value among customers. Unfortunately, industry representatives are beginning to observe certain restaurant chains compromising the quality of their ingredients to improve margins.

Location

Most branches of these mid-to-high end restaurant chains are located within the Central Business Districts (CBD) of Shanghai. While these areas demand a higher rent, they attract the restaurant's target demographic. In fact, much of a restaurant's success relies on finding an optimal location with abundant foot traffic. When selecting a new location, Shao Xing, for example, will look at the number of surrounding businesses, government offices, and hospitals to gauge its market potential. Also, the company looks at the real estate market conditions in the area.

Marketing Activities

These restaurant chains generally do not advertise to the mass public. Instead, they rely on word of mouth endorsements and their reputation to bring in customers. The younger generation often gathers information on restaurants from chat rooms and on-line blogs, looking at everything from reviews to the latest menu offerings. On-site promotions are a popular marketing tool for restaurant chains. In the past, these have included a menu theme highlighting vegetarian dishes, promotional events

such as American seafood month, and cross-promotional campaigns such as partnering with another product like Hagen Daz ice cream. In addition, some restaurants offer VIP discount cards to their loyal customers, a popular business or gift idea. This product engenders customer loyalty while providing the restaurant with steady cash flow to fund their daily operations and to invest in their expansion.

The Whole Package

The restaurant chains highlighted in this report have utilized effective, targeted market research to understand the preferences and spending patterns of their customer base. According to Mr. Gu, the owner of a successful chain of restaurants serving tapas and Mediterranean cuisine, customers easily forget dining out at an independent restaurant. He believes chain restaurants, on the other hand, will thrive in this market due to their ability to understand what the customer wants. That is, like a work of art, they have put together all the different pieces including food, service, atmosphere, and presentation, which are necessary to create a memorable experience for the patron. Mr. Gu goes on to add that “Chinese people no longer view eating as simply a means to getting full. They want a fulfilling dining experience”.

U.S. Products

Many of the chefs, general managers, and purchasing managers interviewed demonstrated a widespread lack of knowledge about U.S. food and beverage products that are suited for their restaurants. Apart from this lack of awareness, the other deterrent to purchasing U.S. food and beverage products was price sensitivity. In general though, these mid-to-high end restaurant chains can afford and desire to use more imported ingredients. Going forward there will be growing demand among restaurant clientele for high-value products such as beef, seafood, and wine. Therefore, it is paramount that U.S. exporters penetrate this market early to establish the relationships and build the name recognition necessary to get U.S. food products into this distribution channel.

C. Procurement Practices and Supply Chain

Domestic Sourcing

Strategic sourcing plays a vital role in simultaneously offering high quality food while maintaining price competitiveness. These chain restaurants primarily source their products from contracted domestic suppliers, which often specialize in one product category. Established, well-known food manufacturers or specialty farms are generally preferred. Suppliers must consistently deliver high-quality ingredients, on-time and in the quantity ordered. It is common for a restaurant chain to develop lasting relationships with their preferred suppliers and distributors. A restaurant that specializes in a particular ingredient may even partner with or become a major shareholder of a select supplier. Such approaches are very different from the strategies employed by independent restaurants, which largely source their ingredients from vendors at wholesale markets.

Sourcing of Imported Products

When it comes to imported ingredients, it is a totally different story. Even a chain restaurant with numerous outlets will more often than not source its ingredients from vendors at a wholesale market. This is especially true with seafood and meat products. Since the volume of imported ingredients is relatively small at the moment, chain restaurants do not directly import from overseas suppliers. Some leading restaurants have expressed interest in directly importing ingredients once volume is sufficiently large. At the moment, a majority of the purchasing managers working in these restaurants lack awareness of the selection and availability of imported U.S. ingredients and their attributes.

When looking at a potential domestic or international supplier, the purchasing department often uses a scoring matrix to grade the supplier. For instance, the team may examine the company’s logistical capabilities, financial condition, and food safety record. After completing this risk assessment, they look at price and quality parameters. If acceptable, the purchasing department would want to sign a preliminary contract to complete a trial run, offering suggestions on process improvements

once the first shipment has been received. The supplier would then have a grace period in which to make any necessary adjustments to their delivery system. Finally, a panel would decide whether they would like to establish a long-term agreement to purchase products from the supplier.

Supply Chain

Mid-to-high end restaurant chains maintain a central kitchen to better manage the flow of goods to their various branches and to expedite cooking times at the restaurant site. Xiao Nan Guo, a leader in the industry, maintains a central warehouse in Shanghai where it processes and handles deliveries of all food ingredients. Out-bound logistics are done in-house, including all deliveries for its home-delivery service. Food safety is a major concern for this restaurant chain. As such, Xiao Nan Guo likes to deal primarily with big Chinese suppliers such as COFCO that handle reputable brands. This allows it to trace food products back to their origin. The company will soon be able to handle direct imports from overseas suppliers. Given their in-house logistical capabilities, this should prove an attractive opportunity for interested U.S. suppliers.

Several industry representatives expressed their displeasure over certain constraints inherent in the domestic supply chain. For instance, according to the head chef at Jade Garden, the supply chain is less responsive than in the past. Due to this problem, restaurants are unable to quickly and reliably source products once R&D develops a new dish. Other major concerns were inconsistent handling along the cold chain, rising transportation costs, and growing difficulties in locally sourcing fresh, high-quality ingredients.

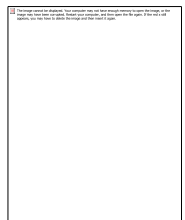
D. Profiles: Major Players in the Mid-to-High End Chain Restaurant Industry

Below are profiles of the major players in the mid-to-high end chain restaurant industry in Shanghai including information about their past, present, and future. The stories behind these restaurants are as varied as the restaurants themselves. However, they all share one commonality, an innate sense of what Chinese customers want and the acumen to shape their businesses accordingly. For this reason, these restaurants should continue to thrive in this competitive environment.

Xiao Nan Guo

Company Background

Xiao Nan Guo traces its origins to a six-table restaurant opened by its founder, Madame Wang, 23 years ago in Shanghai. That year marked the government's opening up of the restaurant industry to private enterprises (previously all restaurants were owned and operated by the state). From these humble beginnings, Xiao Nan Guo has grown its business exponentially. In 1998, Xiao Nan Guo opened a branch in Hong Kong, its first outside of Shanghai. At that time, Madame Wang sought to introduce the relatively wholesome Shanghai cuisine to Hong Kong residents, tourists, and expats in order to change the perception that Chinese food was too oily and unhealthy. Three years ago, the company expanded further, opening branches in Beijing, Nanjing, Suzhou, and Dalian, bringing the total number of restaurants throughout mainland China and Hong Kong to thirty. In 2008, Xiao Nan Guo opened its first international restaurant in Tokyo.



What's Happening Now

Over the years, Xiao Nan Guo has developed a reputation for offering a broad selection of consistently tasty and healthy Shanghaiese dishes at all its locations, meanwhile providing top-quality service. The restaurant mainly appeals to middle and upper class Chinese looking to spend an average of 200 Rmb (\$30) per meal. Madame Wang has done a remarkable job branding the restaurant and outfitting wait staff in trendy, engaging uniforms. More recently, the company has diversified, launching a chain of exclusive, fine-dining establishments called Hui Gong Guan with private dining-rooms. It plans to open four branches in Shanghai during the 2010 World Expo. The company has also started a home-delivery service, a chain of dessert shops, and three spas located in Shanghai. Madame Wang attributes their success during this recent expansion to the company's core competency -

superior management. In fact, she has successfully brought over top-level management personnel from several U.S. companies. These include a newly acquired CFO, a marketing director from a well known PR agency, and a Chief Procurement Officer from Yum Brands, Inc. Xiao Nan Guo imports a limited amount of seafood and condiments from Japan. They offer Carlos Rossi wine from the U.S. at their Xiao Nan Guo branches. They are particularly interested in incorporating U.S. beef into their menu as well as purchasing U.S. pecans, raisins, and dried cranberries for their gift-packages.

Plans for the Future

In the future, Madame Wang “hopes to have the defining company in the hotel & restaurant industry – the standard by which other businesses measure themselves”. The challenge going forward, however, will be for Xiao Nan Guo to retain its unique characteristics while transitioning from a family-run business to a more corporate-style management structure. According to Madame Wang, another constraint the company will face in the future is a diminishing talent pool to fill management positions. Nonetheless, they plan to open additional Xiao Nan Guo branches in Chinese coastal cities over the next five years. Also, they are preparing to expand their line of fine-dining establishments in Shanghai and to make a move into the hotel industry. Perhaps even more impressive though, are preliminary plans to open restaurants in international markets throughout North America and Europe. In order to finance such an aggressive growth strategy, the company will go public in the near future.

Jade Garden

Company Background

The first Jade Garden restaurant was opened in 1999 in Shanghai. Their vision at that time was “to serve authentic Eastern Chinese cuisine prepared using traditional cooking techniques that retain the original essence of the dish meanwhile adding new innovations of their own”. Jade Garden has successfully executed this strategy over the years, building a strong brand name and expanding to major Chinese cities in the process. Currently, there are a total of sixteen Jade Garden locations in Shanghai, Beijing, Macao, Suzhou, Shenzhen, and Hangzhou. More recently, they have launched a Chinese fast food chain called Dou Xiang Yuan and opened a high-end restaurant, Tian Cui Ting, in the Grand Hyatt Shanghai Hotel that serves Cantonese food.



What’s Happening Now

Jade Garden targets white collar business professionals, middle class families, and expats looking to spend an average of 200 Rmb/person, with Xiao Nan Guo and Li Yuan (based in Southern China) being their primary competitors. Jade Garden has succeeded in such a competitive industry by building a highly-competent management team (comprised of 100 people) and focusing on the restaurant’s core competency - classical Eastern Chinese dishes with a modern twist. In addition, they devote significant resources to designing and decorating the interior of their restaurants.

Health and food safety are also important concerns for management. After the R&D department creates a new dish, the purchasing department will decide where best to source it from. Staple ingredients are generally sourced from a specific region (e.g. rice from Dongbei) or a reputable supplier known for delivering a safe and high-quality product. The procurement department prefers to order large quantities and receives product at their central kitchen location. Jade Garden demands good service, consistent quality, and on-time, reliable shipments from its suppliers. Currently, they import lobster and scallops from Canada. While they are interested in purchasing U.S. beef, the head chef was unfamiliar with other U.S. food products. In fact, he was completely unaware the U.S. exports lobster or scallops to China.

Plans for the Future

Jade Garden plans to open an exclusive, fine-dining establishment in the near future that will serve traditional Chinese cuisine. In 2010, the company plans to open an additional eight branches of its flagship restaurant, including its first Jade Garden restaurant in Hong Kong. Jade Garden has also received inquiries from investment companies in New York,

London, and Tokyo interested in opening restaurants in these markets. For the time being, they want to focus on expanding to major coastal cities in China, such as Tianjin and Dalian. Like several other restaurants in the Shanghai area, Jade Garden plans to partially finance their expansion by listing their company on one of the Chinese stock markets.

South Beauty

Company Background

South Beauty, originally called LAN Kitchen, started out in 1991 as a small establishment serving Sichuan cuisine. Nine years later its founder, Madame Zhang, opened the first South Beauty restaurant in Beijing's World Trade Center. She chose to debut her restaurant in Beijing because she felt local residents were already familiar with spicy flavors. Equally important, there was a space in the marketplace for a reasonably priced restaurant that offered business professionals a cozy environment and tasty, clean food. According to Madame Zhang, "Chinese cuisine offers everything, including nutrition and taste, but what has been lacking is the packaging. People in China didn't know how to present the food. I have changed that." Since then the restaurant has taken off with over 40 branches operating throughout Beijing, Shanghai, Chengdu, Nanjing, and Suzhou. More recently, the company has created three new brands, each targeting a different demographic:

- 1) LAN Club [4] - an exclusive club/lounge and restaurant catering to art and fashion enthusiasts as well as foreign tourists and serving both Chinese and Western foods
- 2) STEAM – promoted as a healthy (dishes are prepared using steam) and cheaper alternative to South Beauty with an average check of 100 Rmb/person
- 3) SUBU - decorated by a Danish designer, targeting a younger and trendier clientele

What's Happening Now

South Beauty primarily targets businessmen, upper and middle class families, and tourists looking to pay 150-200 Rmb/meal. The restaurant's main competitors are Xiao Nan Guo, Da Dong, and Jade Garden. Management attributes their success to a clear market positioning supplemented by consistent food quality, a high standard of service, and experience in the restaurant industry. In addition, South Beauty offers its customers a unique regional cuisine, a trendy ambiance, table-side presentation, and fusion dishes. Meanwhile, the company has put together a strong market development team tasked with finding innovative ways to attract new customers and retain existing ones. Recently, the team created a customer loyalty program which offers VIP discount cards to its new partners including the Agricultural Bank of China. South Beauty currently imports a variety of products including seafood and wine. The company uses two distributors, Torres and ASC, to supply its portfolio of wines. Chefs examine the menu on a quarterly basis. Seasonal promotions often incorporate some imported item, such as their Pan Fried Lobster with Red Chilies dish. The company recently hired a Western chef for its LAN restaurant in Shanghai. At the moment, management is experiencing difficulty finding and retaining talented chefs, sous-chefs, and wait staff.

Plans for the Future

South Beauty does not yet operate a central kitchen location but is working on developing one. Management is very deliberate when selecting a new location, first doing intensive market research before making any moves. That being said, they are strongly considering expanding internationally to such locations as Taiwan, Tokyo, and London. The company already operates restaurants in Paris and Jakarta. They are also looking at starting up an outside catering service in the near future.

Shao Xing

Company Background

Shao Xing opened its first restaurant in Shanghai in 1990, the only

establishment at that time to offer Shao Xing regional cuisine in the city. Due to the proximity of the region to Shanghai, the founders correctly predicted that local residents would be familiar enough with the cuisine to frequent their restaurant. Building on their success in the 90's, Shao Xing decided to launch a chain of high-end restaurants in 2004, opening two branches that year under the name Cui Ting Xuan. The company currently owns and operates ten Shao Xing restaurants, two Cui Ting Xuan restaurants, a distillery for producing Shao Xing rice wine, and a seafood processing plant in Zhejiang to produce consumer-ready fishery products.

What's Happening Now

Shao Xing restaurants primarily target Chinese customers earning at least 5,000 Rmb/month (based on an average bill of 150 Rmb/person). These customers generally fall into three broad categories: family, business, or wedding. Their Cui Ting Xuan locations target a higher-end clientele, where the average bill ranges from 300 to 400 Rmb/person. Currently, Shao Xing's main competitors are Feng Shou Ri, Xiao Nan Guo, and Jade Garden. While these restaurant chains appeal to the same customer profile, Shao Xing boasts unique qualities that separate it from the competition such as offering a unique regional cuisine and wine as well as using fresh (often organic) ingredients sourced from its specialty farms.

Shao Xing restaurants are generally larger than their competitors. They devote half the space to open rooms for banquets and traditional table dining and half the space to private dining rooms. This layout keeps their restaurants busy throughout the entire week with the private rooms more popular on the weekdays and the open banquet-style rooms more popular during the weekends.

At present, management is faced with rising labor costs and real estate prices. Also, it is becoming more difficult to source fresh, high-quality products. Shao Xing sources many of its main ingredients from specific areas. For example, fish products are sourced from a fish farm located in the waters of Zhejiang Province and processed at their nearby plant. Currently, their restaurants use imported abalone from Australia and goose liver from France. From the U.S., they use small quantities of imported lobster. Shao Xing is not comfortable importing products directly from the U.S. and will continue to use an importer for such purposes. They would like to procure more U.S. products but cannot meet suppliers' current price ideas.

Plans for the Future

In the future, Shao Xing plans to open smaller restaurants, focusing more on presentation and atmosphere to increase average revenue per table as well as leverage the social aspect of dining out. This strategy also entails expanding the number of the high-end Cui Ting Xuan restaurants. Shao Xing currently has no plans to expand beyond the Shanghai market. If such an expansion were to take place, management would first look to developed markets such as Beijing, Guangzhou, and Macao.

Golden Jaguar

Company Background

Golden Jaguar opened its first restaurant seven years ago in Shanghai. Started by a Taiwanese family, they strove to create a casual and fun international buffet-dining experience. Golden Jaguar has since expanded to a total of ten restaurant locations, with branches in Shanghai, Beijing, Shenyang, Tianjin, and Zhengzhou. At their flagship location in Shanghai,



Golden Jaguar also offers guests fine-dining in their Club du Jardin private rooms as well as large rooms for holding banquets, wedding receptions, company annual parties, and conventions. Meanwhile, Golden Jaguar has also started a catering service which it operates out of this location.

What's Happening Now

Golden Jaguar prides itself for offering customers an international dining experience with over 300 dishes from regions of China, Hong Kong, Japan, Europe, and the U.S. featured on their buffet. In addition to a wide variety of seafood dishes, the buffet also includes Western style roast beef and lamb. Golden Jaguar currently imports seafood from Japan, and they import all wines through a single supplier - Torres.

Golden Jaguar primarily targets middle income Chinese and Western families, overseas and domestic tourists, and business professionals. The open atmosphere and diverse selection of dishes appeal to children in particular. A significant amount of their business is driven by special events such as birthday parties, tour groups, family reunion meals, and business meetings.

According to management, Golden Jaguar's unique pricing strategy limits their competition. At 198 Rmb/person (\$29.10) for an all-you-can-eat lunch buffet, they fall in-between the mid and high-end price ranges for establishments in this restaurant niche. Middle and upper class customers often complain of a limited food selection at the cheaper buffet options (100-150 Rmb/person) while they find most high-end, independent restaurants and hotel-chains serving a buffet to be too pricy at 250-350 Rmb/person as well as too formal. In addition, Golden Jaguar has positioned itself as an ideal place to hold business meetings because it enables companies to simultaneously impress clients while capping meal expenditures.

Plans for the Future

Management has observed that Golden Jaguar branches in Northern China (Beijing/Tianjin) are its most profitable, possibly due to better market perception, limited competition, and/or a different dining culture. Going forward, the company plans to focus more resources in this region. Also, Golden Jaguar will expand to emerging cities such as Nanjing, Wuhan, and Kunming, where they offer local residents a selection of dishes they otherwise would not find in their respective cities. Meanwhile, the company has developed a diversified line of businesses at its flagship location in Shanghai to ensure strong revenue growth in the future. While Golden Jaguar has no intentions of franchising their restaurants; they do plan to go public soon in order to raise additional capital to finance their ongoing operations and future expansion.

The Dong Jiang Seafood Group

Company Background

The Dong Jiang Seafood Group opened their first restaurant in Guangzhou in 1989. A risky venture, its owner poured his life savings from selling vegetables at a local market into starting the seafood restaurant. The restaurant was successful; however, over time the market in Guangzhou became saturated, prompting the group to expand to Shanghai in 1998. Dong Jiang has since opened restaurants in Fushan, Shenzhen, and Nanjing in addition to the 20 branches currently operated in Guangzhou. They specialize in seafood, specifically dishes from Guangdong. The branch in Shanghai has 50 private rooms as well as a large stage area for holding wedding receptions and other such events. In addition, the company has begun promoting the entertainment options at a number of their current venues with everything from KTV to dance clubs.



What's Happening Now

In the past, Dong Jiang Seafood primarily targeted a more affluent clientele. In fact, 30-40 percent of their customers were from the upper class (mainly business professionals) while 50 percent was from the middle class and the remainder from the lower class. They have recently shifted their focus to achieve an optimal breakdown as follows: 10 percent upper class, 70 percent middle class, and 20 percent lower class. For instance, the company has started offering a la carte dishes for breakfast and lunch priced at 15-20 Rmb/dish (\$2.20-\$2.95). Meanwhile, the average bill for dinner is 150-200 Rmb (\$22-\$29.50).

Dong Jiang's primary competitors in the Shanghai market are Xiao Nan Guo and Jade Garden. They are able to compete by focusing specifically on seafood dishes from the Guangdong region, offering a wide range of choices, and providing high quality food and service. Also, the company has an excellent management team and does a superb job decorating the interior of their restaurants.

Dong Jiang sources most of its seafood either locally or from Guangzhou (shipped to Shanghai via air freight). The restaurant currently imports geoduck from Canada, rock lobster and Jacob's Creek wine from Australia, and shrimp from Thailand. They briefly offered Alaskan king crab on their menu, but customers did not feel it was worth the price. Nonetheless, Dong Jiang Seafood Group is interested in getting more information about U.S. food products.

The R&D team often looks at other restaurants to get ideas for new menu offerings. Chefs, who are all from Guangzhou, also will create new menu items. Lastly, suppliers can introduce a new ingredient to the restaurant in which case the executive chef will test it and conduct a trial run to see if it is popular among patrons.

Plans for the Future

Dong Jiang Seafood plans to expand to Hangzhou and Suzhou in the near future. They also are in the process of renovating parts of their restaurants to cater to higher-end customers. Meanwhile, they plan to offer more entertainment options at their restaurants with the addition of KTV and dance clubs.

Bullfighter

Company Background

Bullfighter started as a small stall selling western-style beef dishes at a night market in Taiwan in 1983. Their vision at that time was to offer a "tasty steak at an affordable price". This niche proved lucrative, leading to multiple full service restaurants in Taiwan. In 1999, Bullfighter opened its first mainland restaurant in Shanghai. Initially, they focused on educating customers unfamiliar with eating Western-style beef dishes. By 2003, the company owned and operated nine stores throughout Shanghai. That year they also established a central kitchen location responsible for purchasing, processing, and packaging all major food ingredients, including beef, sauces, and seasonings. This move ensured consistent quality and portion sizes across all locations. In 2004, Bullfighter started selling franchises in other Chinese cities, expanding to ECM's such as Nanjing, Suzhou, Shenzhen, Wenzhou, and Kunming.



What's Happening Now

Bullfighter strives to offer consistent, high-quality beef dishes at all its restaurant locations. To achieve this, every chef receives two months training at their Shanghai central kitchen. In addition, all franchisees are periodically audited to ensure quality standards are maintained. Meanwhile, R&D is performed at their central kitchen location to enhance their current offerings and to develop new dishes. At its Shanghai locations, Bullfighter currently offers a set meal which includes a select piece of beef, a soup, and salad for 98 Rmb (\$14.40). All wine is purchased through their Taiwanese headquarters from one supplier, Torres, which regularly sends representatives to educate chefs and wait staff about their portfolio of wines.

Bullfighter faces two main challenges at the moment. First, their strategy to expand to emerging markets requires that they continuously educate new customers about Western food culture. Secondly, the logistics costs to ship products from their central kitchen in Shanghai to their inland franchises continue to rise due to higher gas prices and transportation costs. Quality control also remains a constant struggle due to inconsistent cold chain handling practices. Currently, Bullfighter utilizes one 3rd party logistics company to deliver product from its central kitchen location to all other branches.

Plans for the Future

Bullfighter is well-positioned to benefit from the increasing per capita consumption of beef in Shanghai (currently estimated at 3 kg/person). Furthermore, as incomes rise in secondary cities, the restaurant will grow their presence in these markets. It also plans to expand to new markets including Ningbo, Chongqing, Chengdu, and Wuhan. Currently there are 45 locations throughout China, with plans to open 19 more in 2010. They are also in the planning stages of opening a bakery division at their central kitchen to supply baked goods (such as appetizers) to all their restaurants. In the future, Bullfighter is keen to directly import U.S. beef once trade restrictions are lifted.

Section III. Opportunities for U.S. Exporters and Recommendations

A. Best Prospects

High-value U.S. products such as beef, chicken, seafood, wine, frozen vegetables, dairy products, nuts, processed fruits, fruit juices, and condiments have the best prospects for penetrating this market. While each product category faces unique challenges, the upside potential cannot be ignored. In addition to gaining access to this massive market, U.S. exporters can use these mid-to-high end restaurant chains as a back door to get into other sectors, such as fine-dining, bakeries, and hotels. Perhaps more importantly, this can lead to opportunities in other channels such as the retail sector.

A.1 Meat

Beef

U.S. beef, known for its superior quality and taste, enjoys a stellar reputation among the Chinese. Not surprisingly, almost every restaurant interviewed expressed interest in incorporating U.S. beef into their menu once trade restrictions are lifted. In particular, restaurant chains specializing in beef dishes are keen to import (perhaps directly) large quantities of U.S. beef in the future.

Chicken

U.S. chicken products have done remarkably well in the Shanghai market, particularly feet/paws and wings. Due to the limited demand for the former in the U.S. market, the low-price point is especially appealing to Chinese restaurant chains. While recent increases in import duties have negatively impacted imports of U.S. chicken products, we expect demand to return to pre-2009 levels once this issue is resolved.

Pork

Upscale restaurant chains in Shanghai are open to using U.S. pork products, although it is not regularly featured on their menus at present. Independent restaurants serving U.S. pork have received accolades from customers for its high-quality suggesting it would do well in a mid-to-high end restaurant. Given the volatility of domestic pork prices, U.S. exporters can offer an attractive alternative during major price upswings.

A marketing strategy often used by restaurants in Shanghai is to promote meat products that are “home raised” or free-range or to describe the origins of the product directly on the menu. U.S. exporters should consider this when marketing their meat products to purchasing managers at Chinese restaurant chains.

A.2 Seafood

Another product category prominently featured on menus at mid-to-high end restaurant chains in Shanghai is seafood. More specifically, restaurants are offering various types of fish, crab, lobster, scallops/abalone, mussels, and squid. Seafood is not only popular for its health benefits but also because it represents a status symbol for the Chinese. Among the imported seafood items currently available are American lobster and king crab, Australian rock lobster and abalone, Canadian lobster, scallops and geoduck, and various seafood items from Japan.

There is a pervasive lack of awareness among local chefs and purchasing managers at these restaurants that the U.S. harvests and exports a variety of seafood products. To remedy this, there needs to be a concerted effort to educate key decision makers within these organizations about the products that are available, their inherent traits, and best practices for handling and preparing them. In the case of New England lobster, many Chinese are unfamiliar with this specific species. Therefore, companies looking to export this product should help chefs understand the unique characteristics it possesses versus rock lobster.

One Shanghai restaurant had a bad experience with Alaskan king crab, saying customers found it to be chewy and not worth the price. This could be a case of improper handling along the cold chain or simply buying an inferior product. Regardless, the Shanghainese demand value and are not willing to spend money simply for the thrill of trying something new. It is imperative that their first experience with a U.S. product be a positive one in order to generate positive word-of-mouth endorsements from customers.

A.3 Wine

The wine market in China is dynamic and multi-faceted. While demand is steadily increasing country-wide, consumption at Chinese mid-to-high end restaurant chains in Shanghai has not caught up with the overall market. This is partly due to ingrained eating habits. Soup or tea often serves as the “beverage” of choice. In other cases, wine may not pair well with the meal. For instance, the custom when dining at a Chinese restaurant is to order multiple dishes to be shared among the table. So it may prove difficult to find a suitable bottle or glass of wine to pair with a wide variety of main courses. Finally, Chinese custom dictates that when dining among friends, family, colleagues, or business partners there should be frequent toasting and subsequent consumption of large amounts of alcohol, often eliminating wine as a suitable beverage.

Nonetheless, many of the restaurants interviewed do include wine on their menu, usually a selection of Chinese labels and a lower-priced imported wine such as Carlos Rossi or Jacobs Creek. Over time, industry experts predict a larger variety of wines will be offered at these restaurant chains, meaning demand for foreign brands should pick up. Meanwhile, affluent Shanghainese are developing a taste for premium wines. However, they are more likely to imbibe while dining at home or at a nice Western restaurant. Case in point, wine by the glass is currently not offered at any of the major Chinese restaurant

chains in Shanghai.

U.S. wine faces the additional challenge of lacking name recognition among Chinese consumers, many of whom are completely unaware the U.S. even produces wine. Therefore, it will take significant time commitment and resources to grab market share from major wine exporters such as France, Australia, and Chile.

As is common practice in the hotel industry in China, many of the restaurant chains have signed exclusive contracts with a single wine supplier. For example, this type of arrangement currently exists between Jacobs Creek and the Dong Jiang Seafood Group and between Torres and both Bullfighter and Golden Jaguar. Thus, it is important for U.S. wine exporters to establish relationships early on in order to capture market share in this growing sector.

To learn more about the wine market in China see the country report **CH9808**.

A.4 Nuts, Dried Fruit, Dairy Products, and Frozen Vegetables

Other U.S. food products that are currently popular among Chinese consumers and should generate interest among chefs and purchasing managers in mid-to-high end restaurant chains are nuts, dried fruit, cheese, butter, potato products, condiments (e.g. hot sauces), and fruit juices.

Nuts and Dried Fruit

U.S. nuts and dried fruit are two product categories with the potential to do well in Chinese restaurant chains. For example, leading HRI groups, such as Xiao Nan Guo, are starting to sell more branded products at their restaurants and other businesses. This helps them build brand awareness among their customer base. Gift packaged items or take-away products are one avenue to cultivate such brand awareness. These gift packages are designed for special occasions and holidays, such as the Chinese mid-autumn festival and Chinese New Year. Chinese consumers are extremely health conscious, meaning dried fruits and nuts are a perfect way to fill these gift packages. In addition, U.S. exporters can market these products as a special ingredient for an innovative dish or provide other creative applications.

Dairy

Dairy products like cheese and butter are becoming a common ingredient used in restaurant chains as chefs look to create new fusion-style dishes, such as Stirred Rice Roasted with Cheese and Shrimp Balls Stuffed with Cheese. Before purchasing dairy products, the R&D team will establish a set of requirements and specifications, such as water content, color, and texture. In the case of cheese, consumers have developed preconceived notions about how it should look and taste from eating at such fast food chains as Pizza Hut. With regards to butter, the Chinese are used to a product that is a distinct yellow. Therefore, most R&D departments opt to cater to consumer's current taste preferences rather than educate them about new products with different attributes, such as Monterrey cheese or margarine from the U.S. Currently, New Zealand is the market leader in these two dairy product categories.

Frozen Vegetables

Similarly, frozen vegetables like potatoes and corn are widely used in the restaurant industry but could be further promoted in Chinese restaurant chains. Take U.S. frozen potatoes for example. The US Potato Board has launched a new marketing program to encourage use of U.S. frozen potatoes in more Chinese cuisine. In addition, the US Potato Board has invited guest chefs to develop recipes incorporating potatoes and has partnered with different Chinese restaurants to promote these dishes. These efforts should begin to pay-off in the near term.

B. Market Entry Strategies

Although overall demand is rising for imported products at mid-to-high end restaurant chains, the U.S. has only managed to capture a small percentage of the market share. The problem has been three-fold:

- Lack of awareness - U.S. products enjoy a high perceived value in the minds of Chinese consumers. In general, they view U.S. products as high-quality and high-status. However, suppliers and restaurants cannot buy that which they do not know exists.
- Lack of availability - Purchasing departments procure most imported products from vendors at wholesale markets or through domestic suppliers/distributors. In this environment, U.S. products must fight for space against a number of competing goods. Meanwhile, quality control can be suspect in these channels.
- Price – While these restaurants can afford to buy imported products, they are still sensitive to price. U.S. imports change hands numerous times along the supply chain, with the price marked up each time.

To overcome these roadblocks, U.S. food exporters and cooperators need to attack the restaurant industry in Shanghai with a two-pronged approach.

- Hold market promotion events that target key decision makers within these organizations such as head chefs and purchasing managers. These events should be relatively small in scale and focus on “selling” U.S. products. The purpose should be to educate guests about the proper techniques in handling, preparing, and presenting U.S. food ingredients and wine. Such events could focus on a single ingredient such as Alaskan king crab, a whole product category such as seafood, or have a regional theme such as Cajun cuisine.

It should also include some type of chef demonstration. Chefs play an extremely important role in deciding which ingredients will be featured at these restaurant chains. They are often the catalyst for R&D. Unfortunately, most Chinese chefs lack awareness about which U.S. food products are available on the market. In addition, they lack the expertise of how to prepare the ingredients or innovative ways to incorporate them into fusion dishes. The head chef at Jade Garden recounted an event he attended recently that offers a good example of how effective such market promotion events can be. The Canadian consular general invited influential chefs from some of the best restaurants in Shanghai to enjoy a meal at his home featuring a variety of Canadian food and wine. It was extremely successful, encouraging Jade Garden and other restaurants to begin importing Canadian seafood, including lobster, scallops, crab, and geoduck.

To coordinate such events can mean developing public-private partnerships whereby U.S. companies, cooperators, and government offices work together to maximize resources and guanxi (relationships). Also, regional promotion has proven an effective marketing tool, whereby cooperators and companies work together to promote similar regional products such as Alaskan seafood, NE crab and lobster, or California wine.

Yet another method for educating local chefs is to foster increased cooperation between Chinese and American chefs through exchange programs with cooking schools in the U.S. In fact, there are a number of existing chef training schools in Shanghai that should be open to developing such partnerships.

Work in conjunction with domestic suppliers and distributors to get U.S. products into restaurant chains. Again, this will require targeting primary decision makers within these organizations. Since restaurants are not willing to divulge their existing supplier base, U.S. companies must develop creative strategies to seek out a reputable third party. This can mean travelling to Shanghai and meeting with referred suppliers and distributors. Another method would be to attend trade shows held in China looking to connect with domestic distributors and suppliers servicing the hotel and restaurant industry. Also, U.S. companies can leverage existing relationships between the ATO Shanghai office and its preferred vendors to set up meetings. Once a suitable distributor or supplier has been found, it is best to approach the restaurant chain together and to seek out the purchasing manager. Like any other industry, the decision on whether or not to use a particular U.S. product will often come down to price and quality. So U.S. companies should come prepared to offer samples, creative pricing packages (with discounts), and product support in the form of training and best handling practices along the supply chain.

Two other viable options exist for getting U.S. products into Chinese restaurant chains. First, U.S. companies can take a less direct approach and simply try to get their products to wholesale markets through an importer. Second, they can seek out larger restaurants such as Xiao Nan Guo and Bullfighter which have expressed interest in importing directly from U.S. suppliers. In fact, this should occur more often in the future as other restaurant chains grow and improve their procurement capabilities. A major advantage to direct imports is the elimination of the “middle men”. That is, by reducing the number of times the product changes hands, U.S. goods become more price competitive.

While these strategies mainly apply to U.S. companies looking to introduce new-to-market products to Shanghai, there are obvious exceptions. For instance, U.S. beef exporters will not need to rely on a push strategy to get back into restaurant chains once import restrictions are lifted. Rather, they will want to identify the best entry point(s) for getting their product into the marketplace. This could mean working with a trusted importer and distributor or seeking out restaurant chains that have the capability to handle direct imports. Also, companies that are already established in China and are looking to expand their market share might suggest that their current distributor consider this emerging sector. With the development of central kitchen locations, restaurant chains in Shanghai can increasingly handle large deliveries and better monitor quality control. Furthermore, as the restaurant industry consolidates and chain restaurants grow, there will be more high volume sales opportunities.

Similar to the wine industry, first movers gain a huge advantage in China. So it is paramount that U.S. exporters begin to penetrate this market early to ensure Shanghainese customers and chefs come to demand U.S. products over competing foreign goods. Indeed, as more U.S. ingredients are featured on menus, customers and chefs will increasingly request U.S. products over competing foreign goods. Equally important, U.S. exporters will see additional sales opportunities as these companies diversify into other lines of business and develop the capability to import directly. This can only happen if U.S. companies commit to putting in the time and resources necessary to get their proverbial “foot in the door”.

End Notes

^[1] The restaurants in this report, which are classified as “mid-to-high end”, have an average bill per customer falling between 150-200 Rmb (\$22 – \$29.50)

^[2] Middle class is defined as comprising households with an annual income between 60,000 Rmb and 500,000 Rmb (\$8,825 to \$73,530)

^[3] Those with an annual household income above 250,000 Rmb (\$36,765)

^[4] Following is the layout of the LAN club in Shanghai: 1st floor – club with live music, 2nd floor – South Beauty restaurant, 3rd floor – private dining rooms, 4th floor - Western restaurant, 5th floor - roof top area for special events

